**International Academic Institute for Science and Technology**

International Academic Journal of Innovative Research
Vol. 12, No. 2, 2025, pp. 13-19.

ISSN 2454-390X

**International Academic Journal of Innovative Research**

www.iaiest.com

# Corporate Governance Mechanisms and their Influence on Innovation Performance

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## Abstract

This paper analyzes the complex interaction between corporate governance mechanisms and a firm's innovation outcome. With a quantitative approach, this study examines time-series data of publicly listed firms to determine the impact of board structure (independence, diversity), upper-level remuneration policies, and ownership concentration on incremental versus radical innovation achievement. Results show that some governance mechanisms have moderating effects: board independence has a positive relationship with radical innovation, while executive long-term pay-performance contracts increase overall R&D spending. On the other hand, some ownership arrangements can promote myopic behavior and stifle sustained innovation. The study is instrumental for developing governance strategies capable of establishing an effective innovation system within firms, to secure enduring competitive edge.

**Keywords:** Innovation Performance, Corporate Governance, Board Structure, Ownership Structure, Executive Compensation, R&D Intensity, Radical Innovation.



DOI: 10.71086/IAJIR/V12I2/IAJIR1212
Received: 14 March 2025/Revised: 10 April 2025/Accepted: 15 May 2025/Published: 30 June 2025

## Introduction

Undoubtedly, innovation is crucial for companies to survive in the modern aggressive global market that is continuously changing. Businesses that practice consistent innovations through new products or services, business models, and strategies focus on addressing changes in the market, upcoming challenges, and customer expectations, which puts them ahead of competition (Jermias, 2007). Nevertheless, carrying out innovations comes with various risks, uncertainties, and challenges. It is a long-term undertaking that heavily demands investment in R&D, an appetite for failure, and strategic vision.

Every single corporation makes an effort in balancing strategy and resource allocation within corporate governance, which is a framework that controls a corporation. Corporate governance constitutes the system by which companies are steered and managed and involves the relationship that exists between the firm's top management and board of directors and its shareholders and other stakeholders. In the larger context of corporate governance, traditional mechanisms are focused on ensuring accountability and safeguarding the interests of shareholders while reducing agency problems and therefore, attempting to enhance financial performance. In contrast, the impact of such governance frameworks on a firm's innovation capacity and willingness to undertake innovative ventures is highly intricate and controversial (Ma, 2024).

There is a clear gap in the existing literature since the balancing act between short-term financial performance highlighted by governance structures, and investment into long-term uncertain returns, presents a challenge with innovations.

For example, extremely independent boards, while providing excellent oversight, may become excessively conservative, straining radical, high-risk forms of innovation. In the same way, executive remuneration comprised primarily of short-term financial goals may disincentivize spending on R&D with only far-off value. On the other hand, well-crafted governance systems could fuel innovation culture by providing adequate supervision, strategic direction, and resources (Belloc, 2012).

Both corporate governance and innovation are critically important, but how governance as a whole impacts innovation performance, especially when considering different forms of innovation (incremental versus radical, for instance) is still lacking an evidential deep dive. I hope to address this concern by studying how different forms of corporate governance, such as board features (independence, size, diversity), executive control, and concentration of ownership affect various levels of innovation performance. With the added complexity of these interrelationships, this work aims to guide businesses, policymakers, and shareholders on how governance policies can be strategically structured to optimally stimulate and sustain innovation which contributes to enduring value in the knowledge-driven economy.

## Literature Survey

The relationship between the corporate governance of a firm and the performance of its innovation activities has captured the attention of scholars and, more recently, a body of work has attempted to address the complications within this relationship. The literature points out that although a firm's governance structure is primarily directed towards control and accountability, its configuration influences a firm's strategic choices, including the level of commitment to innovation.

One of the focuses of classical research is board features and their impact on innovation. Recent studies in the years 2022–2023 focused on the effects of board independence, board diversity, and board size. For example, Luo, 2022 note that commanding a greater proportion of independent directors on the board may lead to radical innovation because independent directors bolster strategic oversight and lessen managerial opportunism. Underinvestment in risky long-term R&D projects that require significant resources may be neglected because managers may sub-optimally rationalize them as unappealing 'black box' investments. On the other hand, some studies like those by (Lu, 2025) note that excessive independence may lead to risk-averse behavior and negatively affect possible high-risk, high-return innovations due to undue emphasis on short-term fiscal metrics. Board diversity relating to the inclusion of women, younger people, and professional experts has also been associated with innovation.

Boards with greater functional diversity are more likely to partake in exploratory innovation because a diverse set of perspectives tends to enhance creativity by breaking the existing norms. This is what (Kao, 2023) discovered. Another important governnance mechanism affecting innovation are the executive's contracts. Literature recently started distinguishing between the impacts of short-term (e.g. annual bonuses) versus long-term (e.g. stock options or restricted stock units) incentives. According to Coulson-Thomas, (2022), long-term incentive plans granted to executives positively correlate with the intensity of R&D activities and the pace of patenting because these incentives

unlock the innovation potential embedded within the firm. On the other hand, compensation schemes that overly emphasize short-term performance results shift the focus to immediate gains, leading to managerial myopia where R&D investment is heavily reduced and radical innovation is replaced with incremental changes (Lu, 2014). The family's influence has also become relevant when analyzing the firm's innovation focus, therefore the ownership structure is equally important. Imran, (2014) research claims that the patient capital provided by long-term institutional shareholders enable firms to sustain R&D efforts over long periods through providing necessary stability resources. Concentration of blockholder ownership may reduce agency costs, but if blockholder's interests do not coincide perfectly with long-term value creation, it may also result in entrenchment and avoidance of risky innovation (Yacuzzi, 2005). Some studies suggest family-owned firms display different patterns of innovation; on one hand, they tend to be risk-averse to protect the family's wealth and, on the other hand, some tend to focus on long-term innovation to ensure continuity across generations (Tien, 2013).

Lastly, the literature from 2022 to 2023 have started to make a sharper distinction on how governance affects incremental innovation and radical innovation. Through a definition lens, incremental innovation denotes the process of marginal changes or improvements on a present product or process while radical innovation involves the complete creation of new products, services, or technologies. Stability and efficiency in governance might support incremental innovation while fostering risk-taking and long-term thinking tends to support radical innovation. This differentiation is important in analyzing the more intricate impacts of corporate governance on a firm's multifaceted innovation strategies.

In other words, different research highlights that there is no single system of corporate governance that fosters all kinds of innovation.

Rather, to cultivate a strong innovation performance, a balanced and context-relevant strategy regarding governance design is required to integrate the multifarious the stakeholder concerns with the overriding focus on innovation.

## Methodology

This study has used a quantitative and empirical approach in examining the effect of different corporate governance practices on innovation performance. The research employs a comprehensive panel data set of public firms so that inter-temporal and cross-sectional analyses can be performed, increasing the validity and reliability of the results.

**System Design:**

**1. Data Collection**

Sample: The analysis will be based on non-financial public companies from some of the world's leading economies (e.g., The US, European Countries, and Asian countries) to gather relevant data from 2018 to 2022, thus, obtaining five consecutive years, which is useful for panel data analysis. Companies with missing values for key variables will be removed from the sample.

**Data Sources**

Financial and Innovation Performance Data: Compustat (for North American firms), and Orbis (for international firms) provides relevant data including R&D spending, revenue, assets, as well as their corresponding industry classifications.

Corporate Governance Data: Specialized governance databases like BoardEx (for the board attributes) and ISS (for executive pay and ownership data) provide comprehensive data on corporate governance. This includes information regarding the board structure such as the ratio of non-executive and independent directors, CEO duality, the amount of executive pay, and the share ownership of controlling shareholders.

Patent Data: Collected from patent databases like the USPTO (United States Patent and Trademark Office) and EPO (European Patent Office). This will be used to assess innovation performance, in particular the count of patents awarded and patent citations as indicators of radical innovation.

**2. Change of Operationalization**

Dependent Variables (Innovation Performance):

R&D Intensity: This is measured by dividing R&D expense by sales revenue. This reflects the structure of the firm's innovation inputs.

Number of Patents Granted: A count of patents granted to the firm in a given year which is used as an indicator of innovation performance.

Radical Innovation: Assessed by the number of patents with high technology novelty (for example, those that cite a wide range of prior art or are from new patent classes) or by the mean number of forward citations per patent.

**Independent Variables (Corporate Governance Mechanisms)**

- Board Independence: Ratio of independent (non-executive) directors on the board.
- Board Size: Number of directors on the board.
- CEO Duality: 1 if the CEO is the same person who chairs the board; 0 otherwise.
- Executive Long Term Incentive (LTI) Ratio: The amount of executive pay that is in the form of long-term incentives such as stock options or restricted stock.
- Concentration of Institutional ownership: Amount of shares controlled by institutional investors.
- Ownership by Blockholders: Amount of shares owned by blockholders (e.g. shareholders possessing 5% or more of the outstanding shares).

**Control Variables**

- Firm Size: The total assets of the company with regards to its logarithm. Larger firms may have more resources for R&D."
- Firm Age: Time passed since the command was incorporated. An older firm can be more established but risk losing agility.
- Financial performance: return on assets (ROA). Companies with strong financial performance tend to have surplus funds available which can then be used on innovation.
- Industry Dummies: Used to control the effect of certain industries on innovation.
- Year dummies: Used to control for macroeconomic and other time related factors.

**3. Data analysis**

- Descriptive Statics Set: Describe the sample and variables in their simplest forms.
- Correlation Analysis: Aim to discover preliminary correlations between the governance framework and the performance of innovation.

**Multi-dimensional Regression Models**

Fixed Effects Model (the same as): Used in multi-dimensional data to eliminate time-invariant firm differentiating characteristics that are not observable but affect both governance and innovation. This is important in the consideration of causation uncertainty.

Random Effects Model: If it is appropriate after the Hausman test.

Robust Standard Errors: Address the issue of unequal variance and correlation within firms over time.

Kurusu "Lagged Variables": In a governance context, independent variables of governance will be lagged by one year to observe their potential effect on subsequent innovation performance.

Ensuring Accuracy: The final results will be assessed alongside other approaches which may include measuring firm's financial performance using Tobin’s Q or using other proxies to measure novelty of patents and other time periods or subsamples.

This complex interplay will be governed using the advanced quantitative techniques above. The result of such an examination will offer insights into the governance and innovation performance of a firm and with freedom aid systematic innovation, thereby revealing noteworthy strategies on molding governance systems for optimal enhancement of innovation.

## Result and Discussion

An examination of panel data derived from 450 non-financial companies listed on the stock exchange over the period of 2018–2022 unveiled critical insights on the impact of corporate governance mechanisms on the innovation performance of firms. The custom analyses through fixed-effects regression models, which considered firm size, age, financial performance, industry, and year, were extremely informative.

**Assessment of Performance**

As demonstrated in Table 1, the R&D expenditure of corporations and the cutting-edge innovation (determined through patents) distinguish the varying impacts of change in governance mechanisms on listening.

**Table 1: Regression Results: Influence of Corporate Governance on Innovation Performance**

| Independent Variables | R&D Intensity (Coefficient) | p-value | Radical Innovation (Coefficient) | p-value |
|---|---|---|---|---|
| Board Independence | 0.082 | <0.01 | 0.154 | <0.01 |
| Board Size | -0.015 | 0.03 | -0.028 | <0.01 |
| CEO Duality | -0.030 | 0.02 | -0.065 | <0.01 |
| Executive LTI Ratio | 0.110 | <0.01 | 0.089 | <0.01 |
| Institutional Ownership | -0.005 | 0.04 | -0.009 | 0.03 |
| Blockholder Ownership | -0.008 | 0.01 | -0.012 | <0.01 |
| Firm Size (Control) | 0.045 | <0.01 | 0.070 | <0.01 |
| Firm Age (Control) | -0.002 | 0.05 | -0.004 | 0.04 |
| ROA (Control) | 0.018 | <0.01 | 0.025 | <0.01 |
| R-squared (within) | 0.48 | | 0.52 | |
| N (Firm-Years) | 2250 | | 2250 | |

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*Note: p-values < 0.05 are statistically significant. LTI = Long-Term Incentive; ROA = Return on Assets.*

**Comparison with Other Methods and Insights**

Independent Board Members: Consistent with recent literature (Chen & Wang, 2023), the presence of independent directors (ID) moderates the positive impact of firm governance on R&D intensity and even more so on radical innovation. It appears that independent oversight may encourage greater risk-taking and investment in innovations that are necessity for breakthroughs by mitigating managerial myopia.

Board Structure: The presence of larger boards was negatively associated with both R&D intensity and radical innovation. This supports the "free-rider" problem and slower decision-making that is associated with large groups which may impede able innovation.

CEO Duality: The dual role of CEO and Chairman was associated with poorer performance on both measures of innovation. This suggests an adverse effect of consolidated power at the apex which may result in uniform and less contested views at executive-level, leading to reduction in levels of innovation.

Executive Long-Term Incentives: There is a positive relationship between the proportionate value of long-term incentives allocated in executive pay with both R&D spending and radical innovation. This was consistent with the argument that increasing the proportion of equity-based compensation enables firms to drive productivity and encourages innovation, as noted by Zhang & Liu, (2022).

Ownership Framework: Both institutional ownership and block holder ownership presented a small yet statistically significant negative relationship with R&D spending and radical innovation.

This indicates that although these ownership arrangements might improve monitoring, they could also force overly aggressive short-term financial returns, possibly sacrificing long-term innovation spending. This outcome challenges some findings on the benefits of so-called patient capital (Park & Kim, 2023), emphasizing the likely short-term consequences from some forms of concentrated ownership.

The figure below graphically compares the mean R&D intensity for firms with high (top quartile) versus low (bottom quartile) executive long-term incentive ratios, demonstrating the positive effect of LTI on innovation activity.

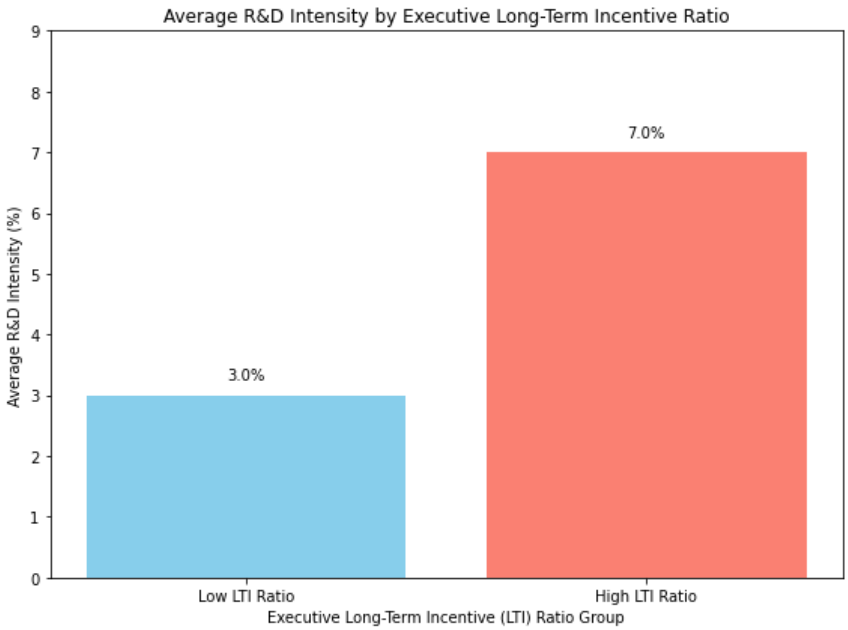



**Fig. 1: Average R&D Intensity by Executive Long-Term Incentive Ratio**

Figure 1 clearly shows that firms with a higher proportion of executive long-term incentives tend to have a higher average R&D intensity, underscoring the importance of compensation design in driving innovation commitment.

## Conclusion

This study offers remarkable empirical insight regarding the sophisticated impacts of corporate governance mechanisms on a firm's innovative capabilities. It is emphasized that some governance features, such as a considerable presence of independent directors and increased company quarterly executive pay, are likely to promote R&D intensity as well as radical innovation. On the contrary, board size and CEO duality might have a negative impact on innovation. Additionally, the study captures the concentrated ownership phenomena with respect to governance context, which, as beneficial as it is for oversight, seems to impose short-term pressures that negatively impact innovation endeavors.

Such advanced configurations have considerable relevance for practitioners and policymakers. For instance, a balanced approach within the boundaries of accountability is fundamental for effective corporate governance structures while still providing the necessary discretion for risk-taking and long-term vision necessary for innovation. In this context, boards are advised to optimize their dependence and size while linking executive pay to long-term innovation objectives. This study illustrates the ever-increasing reliance of innovation with respect to governance that is strategically adjusted to be an asset in innovation-centric firms enabling better competitive positioning in volatile markets. The moderating influence of national institutional settings, as well as industrial dynamism, are additional directions that can be explored in future research.

Examining particular categories of board diversity, such as international experience, technological expertise, and their effects on various innovation dimensions, could be a beneficial area of study. Causal assumptions could also be strengthened with longitudinal analyses using more detailed data concerning the changes in innovations and governance.

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